VZCZCXRO2951
PP RUEHAG RUEHROV RUEHSL RUEHSR
DE RUEHRL #0181/01 0431904
ZNY CCCCC ZZH
P 121904Z FEB 10
FM AMEMBASSY BERLIN
TO RUEHC/SECSTATE WASHDC PRIORITY 6548
INFO RUCNMEM/EU MEMBER STATES COLLECTIVE PRIORITY
RUEHTH/AMEMBASSY ATHENS PRIORITY 0015
RUEHFT/AMCONSUL FRANKFURT PRIORITY 0008
RUEHMZ/AMCONSUL MUNICH PRIORITY 2247
RUEHBS/USEU BRUSSELS PRIORITY
RUEHC/DEPT OF LABOR WASHINGTON DC PRIORITY
RUEATRS/DEPT OF TREASURY WASHINGTON DC PRIORITY

C O N F I D E N T I A L SECTION 01 OF 03 BERLIN 000181

SIPDIS

STATE FOR EEB (NELSON, HASTINGS), EEB/IFD/OMA
(WHITTINGTON), DRL/ILCSR AND EUR/CE (SCHROEDER, HODGES)
LABOR FOR ILAB (BRUMFIELD)
TREASURY FOR SMART, ICN (NORTON), IMB AND OASIA
SIPDIS

E.O. 12958: DECL: 02/12/2020
TAGS: EAID EFIN ECON PREL EUN GM GR PGOV
SUBJECT: GERMANY RELIEVED BY EU SUMMIT OUTCOME ON GREECE

Classified By: ECONOMIC COUNSELOR INGRID KOLLIST, REASONS: 1.4 (B) AND (D)

¶1. (C) SUMMARY: Chancellor Angela Merkel's government welcomed the decision taken at the EU's February 11 informal summit in Brussels not to provide financial assistance, for the moment, to cash-strapped Greece. German officials believe a bailout is not needed at this time, and that extending a lifeline to Greece would have carried too many risks. One major fear in Germany is that "saving" Greece would lead to other needy Eurozone members expecting the same treatment. Another concern is that extending an explicit guarantee for Greece could weigh on Germany's own good standing in the markets, ultimately raising its borrowing costs. While German government officials do not totally rule out an IMF program for Greece if push came to shove, most consider this eventuality highly unlikely, especially in light of the European Central Bank's strong opposition. In fact, the German government, the ECB and private German economists are downplaying the seriousness of Greece's predicament and its potential impact on stability of the Euro. They agree, however, that the crisis could have longer-term consequences for EU institutions and how they interact with member states that stray off course. END SUMMARY.

NOT IN THE MOOD

¶2. (C) Prior to the February 11 EU Summit in Brussels, there was much hair pulling in Berlin over the wisdom of participating in some sort of Greek rescue. No one savored the idea of explaining to German taxpayers, already concerned about Germany's record deficit, that they would be footing the bill for the irresponsible behavior of another country. A Finance Ministry official explained to us that many Germans felt disgusted by the situation in Greece: "While Germans have spent the past decade tightening their belts and improving their competitiveness, Greek civil servants still earn 14 months' salary per year." A recent editorial in the German daily Frankfurter Allgemeine Zeitung (FAZ) asked rhetorically whether Germans would need to work until age 69 just to finance early retirement for Greek workers. With important upcoming elections in the state of North Rhine-Westphalia, bailing out Greece would not be a vote winner.

OFF THE HOOK

¶3. (C) The German government was, in fact, "relieved" that the European Council meeting on February 11 decided not to put concrete assistance on the table at this time. Wolfgang Merz, Director for European Financial Affairs, German Ministry of Finance, told us that while Germany stands ready to throw a lifeline if the Greek government truly runs aground, Greece currently has access to capital markets and needs no outside assistance. The key to overcoming the crisis will be the Greek government's implementation of the planned austerity measures, said Merz. Bernhard Speyer, Head of Banking, Financial Markets and Regulation at Deutsche Bank (DB) Research, agreed that the EU struck the right balance: "The decision gave reassurances that Greece would not be abandoned, but kept the pressure on the Greeks by not yet putting cash on the table."

¶4. (C) Stepping in with assistance at this point carried too many downside risks, according to Merz. Legal questions aside, a German or EU bailout of Greece might have harmed Germany's credit worthiness, thereby raising its own borrowing costs. Merz added that a bailout would certainly have set a bad precedent for other Eurozone countries, such as Spain and Portugal, experiencing similar stresses. (Merz acknowledged, however, that these two countries' problems were less acute -- a sentiment echoed by Speyer.)

¶5. (C)Still, there is some skepticism that Greece's austerity program will get the country's finances on the right track, even if fully implemented. Merz said an IMF bail out remained on the table, despite the official line that the

situation in Greece could be addressed within the EU.

IMF RESCUE? RESOUNDING NO FROM ECB

¶6. (C) According to Karlheinz Bischofberger, Deputy Head of the Financial Stability Department at the European Central Bank (ECB), the likelihood that the IMF will be asked to bail out Greece is "zero." Greece does not have a balance of payments crisis, so there is first and foremost no basis for the IMF to step in. Bischofberger added that apart from the damage to the ECB's reputation an IMF intervention would inflict, it was uncertain that the IMF could even succeed in doing the "political dirty work" of forcing Greece to implement a structural adjustment program. DB Research's Speyer concurred, adding that it would undermine the credibility of EU institutions to manage a crisis.

REPORTS OF MY DEATH ARE GREATLY EXAGGERATED

¶7. (C) Talk of a possible break-up of the Eurozone is "absurd," according to Moritz Kraemer, Managing Director, Standard and Poor's. He noted that Eurozone membership is still seen as highly desirable, and there was absolutely no incentive to exit, despite the allure of devaluation. Any country that tried to leave the Eurozone would get hammered in the credit markets, exacerbating any underlying structural problems. S and P estimates that Greece's rating in the case of an exit would drop to "BB " or lower, i.e. below investment-grade. Even today, Greece's rating of "BBB " is higher than it was in 1997 ("BBB-") before joining the common currency.

¶8. (C) While the current crisis may have revealed an "Achilles heel" of the Eurozone, it may present opportunities, according to Klaus Masuch, Head of the EU Country Division, Directorat General of Economics, ECB. The crisis is a "healthy warning signal" that Eurozone members must conduct "sound national policies in line with the agreed rules." It also underlines the necessity of better integration and coordination of member state fiscal policies. The Euro will come out of this crisis strengthened, he said.

Better and stricter early warning and surveillance systems will be in place, and the Stability and Growth Pact will ultimately be reinforced. DB Research's Speyer agreed, adding that the crisis could make EU member states proceed more cautiously with enlargement.

A EUROZONE CHAPTER 11

¶9. (C) DB Chief Economist Thomas Mayer told Ambassador Murphy he was pessimistic Greece would take the difficult steps needed to put its house in order. A worst case scenario, says Mayer, could be that Germany pulls out of the Eurozone altogether in 20 years time. In 1990, Germany's Constitutional Court ruled that the country could withdraw from the Euro if: 1) the currency union became an "inflationary zone," or 2) the German taxpayer became the Eurozone's "de facto bailout provider." Mayer proposes a "Chapter 11 for Eurozone countries," which would place troubled members under economic supervision until they put their house in order. Unfortunately, there is no serious discussion of this underway, he lamented.

COMMENT

¶10. (C) Chancellor Merkel is clearly relieved she does not, for now, have to explain to the public why the German government is running up its own deficit to bail out debt-laden Greece. Still, the German government appears prepared to step in as a last resort if needed and is cognizant that German banks (such as Hypo Real Estate and Deutsche Bank) and insurance companies (Allianz) have significant exposure to Greek sovereign debt. The crisis is also viewed -- within the German government as well as within the ECB -- as a way to exert greater influence over the public finances of profligate Eurozone members. Some

Christian Social Union (CSU) politicians are even using the crisis to promote the candidacy of Bundesbank President Axel Weber as next ECB President, arguing that Weber's selection would send a signal that Eurozone stability is paramount. One way or another, the consequences of the Greece crisis seem likely to outlive the immediate situation. One strong possibility is that German influence over policy in the common currency area will grow.

¶11. (U) Embassy Berlin and ConGen Frankfurt co-drafted this cable.
Murphy